ANNUAL REPORT 2003

Hillsborough Resources Limited

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Hillsborough Resources Limited is a Canadian based coal mining company traded on the Toronto stock Exchange under the symbol HLB.

Its principal asset is the wholly owned Quinsam Coal mine located near Campbell River, British Columbia. Quinsam produces a very high quality thermal coal much sought after by power plants and other industrial users.

Management of Hillsborough Resources believes that shareholder value is best created through the successful execution of a sound growth strategy. Last year we articulated the four key cornerstones of this growth strategy. We are pleased to report to you what our accomplishments were in executing this strategy.

expanding
the core business

developing
our coal bed methane potential

furthering
the power project

developing
new mining operations

In expanding the core business we had four critical achievements, namely:

1. We were successful in securing regular sales into the newly developed pulp and paper market.
2. We were awarded a two year contract to supply a major cement manufacture coal for two of its plants located in the Pacific Northwest and we also extended a second contract by three more years.
3. We were successful in acquiring the assets of the Middle Point barge loading facility which will reduce the cost of transporting Quinsam's coal for almost all customers. Management believes that it will be successful in moving other bulk commodities through the Middle Point facility creating an entirely new source of earnings and cash flow for the company.
4. Finally, Quinsam coal was awarded the prestigious JT Ryan award for safety (for the second time in three years) and for the fifth consecutive year it was awarded the B.C. Small Underground Safety Award.

In developing our coal bed methane potential we have finally reached agreement with the Government of British Columbia to return to Quinsam the ownership of the CBM. The legal agreements have been drafted and are awaiting execution. We are hopeful that we will be able to drill one or two exploration holes this year. Meanwhile we are continuing to develop our geological models and remain very excited about the potential for a commercial gas discovery.

In furthering the power project we along with others successfully intervened in the public hearings respecting the application by B.C. Hydro to build a natural gas powered generation facility at Nanaimo. The result of this hearing was that B.C. Hydro was directed to conduct a call for tenders for electricity supply solely on Vancouver Island. To improve the competitiveness of our project we partnered with Cinergy Solutions of Cincinnati, Ohio. Cinergy was chosen because of its superior technical expertise in building and operating coal fired power plants and because it has the necessary financial strength to ensure the project can be financed. We are currently participating in the tender process being run by B.C. Hydro.

In the area of developing new mining operations we completed a successful drill program on an industrial minerals property and were successful in expanding the size of the resource. Additional exploration drilling is being planned for this year. We are also actively negotiating with a few individuals in the hopes of acquiring the rights to a metallurgical coal property in British Columbia.

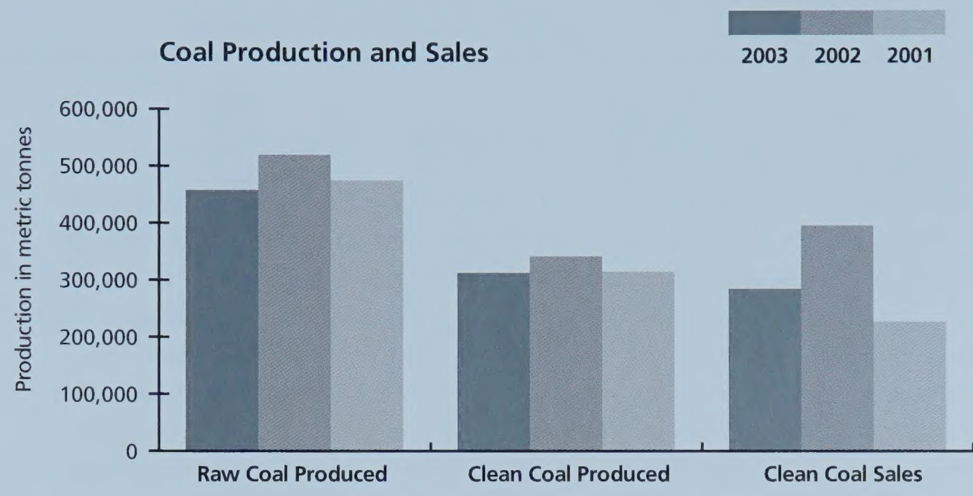
A) Production and Sales

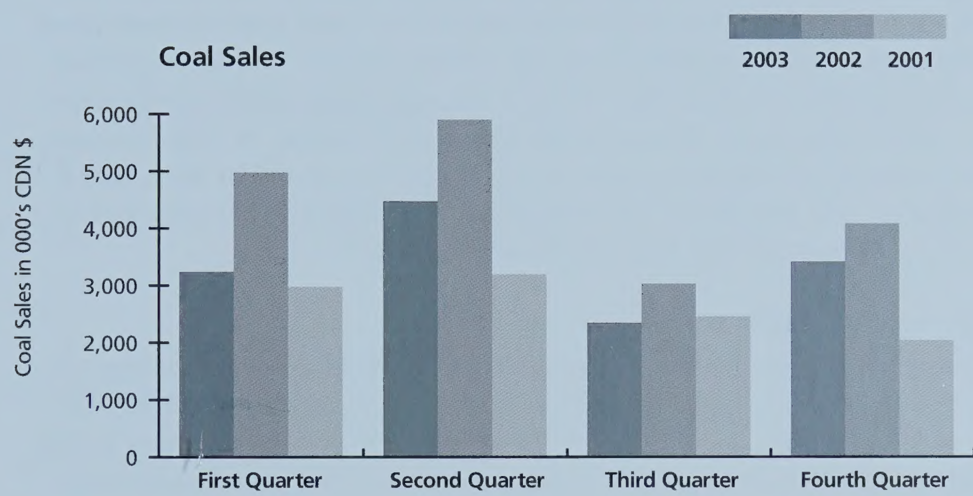
In general, it is the intent of the Company to match as closely as possible clean coal production to sales. The domestic sales made by the Company are contractual in nature and the volumes are generally spread evenly throughout the year. In 2001 and 2002 the level of domestic business approximated 220,000 tonnes. This increased to roughly 240,000 tonnes in 2003. In 2004, it is anticipated that approximately 360,000 tonnes will be sold into the domestic market. Spot sales are sold in ship load quantities and they range between 45,000 and 70,000 tonnes. If the Company is contemplating a spot sale it will have to build inventory beginning two to three months in advance of the planned delivery date. The Company's ability to profitably participate in the spot market is dependant upon the prevailing spot price, expected production and transportation costs, mine production costs and the prevailing foreign exchange rate. In 2003, the Company withdrew from the spot market. Market fundamentals have improved allowing the Company to sell into the spot market in 2004.

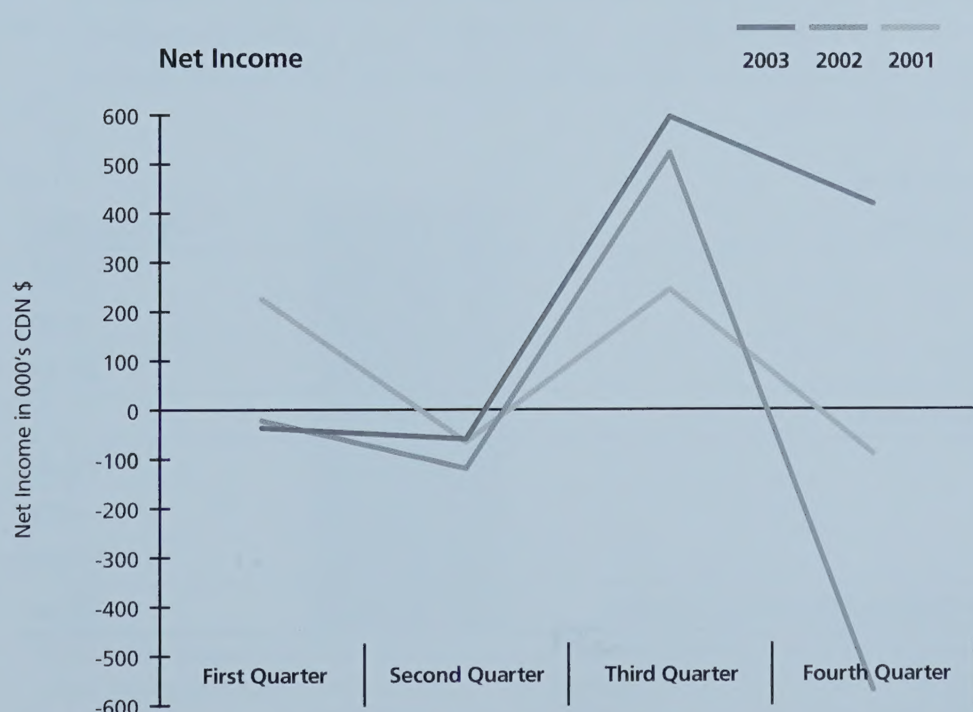
B) Coal Sales and Net Income

In any given quarter, the volume of sales is affected by whether a spot shipment occurs. In 2003, a spot sale totaling 49,504 tonnes occurred in the first quarter, whereas in 2002 spot sales totaled 175,706 tonnes and were recorded in the first and second quarters. In 2001 spot sales were zero. The total sales volume in 2003 was 284,372 tonnes; in 2002 it was 395,127 tonnes and in 2001 it was 226,413 tonnes. The contractual domestic business in 2001 and 2002 was approximately the same; however, it increased significantly in 2003 and will increase again in 2004. The transportation costs associated with spot sales are greater than those costs for the domestic sales. Therefore, the relative profitability of spot sales is dependant upon the spot price denominated in US dollars and the prevailing foreign exchange rate. Predicting the future profitability based upon past results must be done with caution because the interrelationship among production volumes, production costs, the mix between spot and contractual sales, and the prevailing spot price and foreign exchange rates will all interact to result in a unique financial performance for the period being considered.

Earnings can also be influenced by activity not related to coal operations. For example, in the third quarter of 2002, there was a substantial gain on sale of parts and equipment and in the third quarter of 2003 there was a gain from the reversal of certain creditor liabilities. The fourth quarter of 2003 is reflective of the ongoing profitability from domestic sales. Domestic sales are supplemented by spot sales as appropriate. Investors should monitor prices in the spot market to determine if the Company will be continuing to participate in the spot market. On a seasonal basis, the first quarter typically has lower volumes as the Company's domestic customers often have maintenance closures early in the first quarter. Therefore whenever possible the Company will attempt to schedule spot sales for the first quarter.


Coal Production and Sales
2003
2002
2001
Production in metric tonnes
600,000
500,000
400,000
300,000
200,000
100,000
0
Raw Coal Produced
Clean Coal Produced
Clean Coal Sales


Coal Sales
2003
2002
2001
Coal Sales in 000's CDN $
6,000
5,000
4,000
3,000
2,000
1,000
0
First Quarter
Second Quarter
Third Quarter
Fourth Quarter


Net Income
2003
2002
2001
Net Income in 000's CDN $
600
500
400
300
200
100
0
-100
-200
-300
-400
-500
-600
First Quarter
Second Quarter
Third Quarter
Fourth Quarter

C) Realized price and Operating Costs

In 2003, the majority of the Company's sales were in the domestic market, except for a small spot sale in the second quarter. In the second quarter of 2003, 32% of the sales were into the spot market which explains the lower average price. In 2002, spot sales were made in the first and second quarters with the second quarter sale at a lower US dollar denominated price than for the first quarter sale. In 2001, all of the sales were made into the domestic market. The Company's domestic sales are under long term contracts with the terms remaining being one, two and three years. There is one contract in the domestic market which is denominated in U.S. dollars. In general, sales made under contract are adjusted at the beginning of each contract year by an inflation index. Apart from changes in the cost of materials and supplies, the factors which influence costs included the total level of production, yields from the wash plant, and the ratio of development coal production to depillar coal production. De-pillar production is lower cost than development coal production. In 2001, the majority of production was from de-pillar coal which explains the overall favourable production performance. In 2003, the yield from the wash plant averaged 70.8% compared to 65.7% in 2002 and 66.3% in 2001. Typical yields range between 67% and 70%. Total clean coal production in 2003 was 312,267 tonnes compared to 341,432 tonnes in 2002 and 314,483 tonnes in 2001.

D) Share Price and Volume Performance

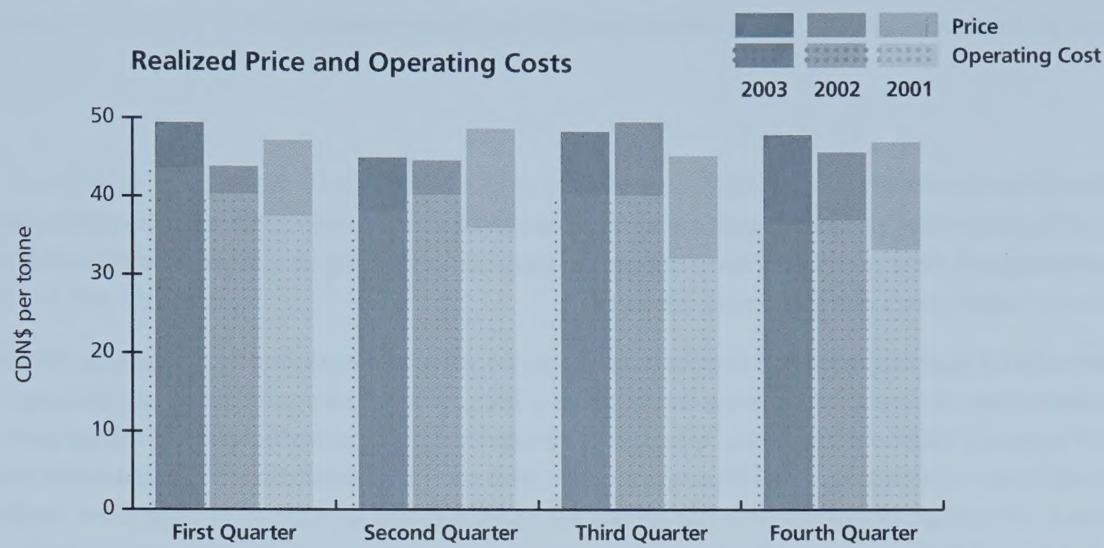
The total number of common shares which traded in 2003 was 18.1 million or on average 1.5 million per month. This compares to 14.8 million shares or 1.2 million per month in 2002 and 15.9 million or 1.3 million per month in 2001.On a daily basis over 70,000 shares traded in 2003 compared to 59,100 and 62,500 in 2002 and 2001, respectively. The share price trading range (for closing prices) in 2003 was from a low of $0.175 in May to a high $0.64 in December. In 2002, the trading range was $0.30 (October) to a high of $0.67 (July). In 2001, the trading range for the common shares of Hillsborough Resources Limited was from a low of $0.32 in January to a high of $1.40 in May.

Reserve and Resource Table

RESERVES (million tonnes)	Dec 31, 2003	Dec 31, 2002
Proven	23.00	14.50
Probable	0.60	6.30
Subtotal Reserves	**23.60**	**20.80**
RESOURCES (million tonnes)		
Reserves	23.60	20.80
Measured	1.10	4.73
Indicated	0.66	0.97
TOTAL RESERVES & RESOURCES (million tonnes)	**25.36**	**26.50**

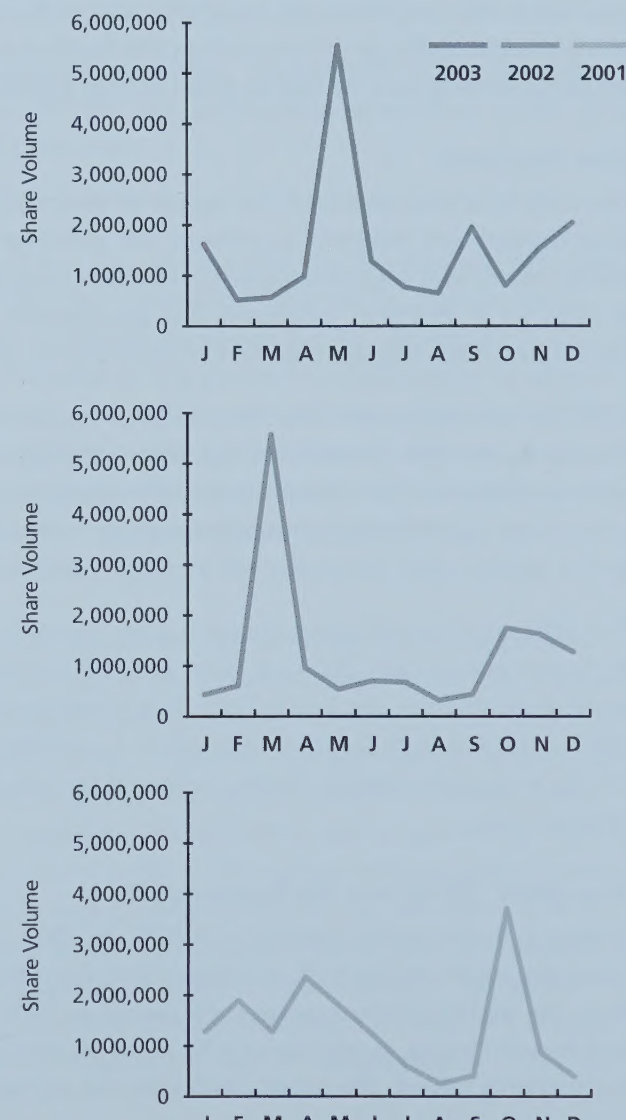
NOTES: *Reserves were prepared under the direction of Mr. Kresho Galovich, P. Eng., a qualified person in accordance with N.I. 43-101. Resources were prepared under the direction of Mr. Steven Gardner, P. Geo., a qualified person in accordance with N.I. 43-101. Approximately 8.26 million tonnes of the Total Reserves and Resources are below 1% sulphur.*

Realized Price and Operating Costs



Share Price Performance

Share Volume Performance



My Fellow Shareholders,

As I write this letter, the business climate for Hillsborough has never been so positive. In 2003, we have made significant progress on a number of very important projects as we began to implement some of our strategic objectives of which you were previously advised.

The international coal market began to show increasing signs of strength in the last quarter of 2003, and this has continued into this year. We believe there are two factors contributing to this strengthening. The first is that the People's Republic of China has emerged as a significant net importer of coal, whereas, in the past it has typically been a net exporter of coal. We believe that the rapid expansion of the domestic market in China has created a shortage of energy. This has forced the domestic coal producers to supply the local market, which in turn has forced their customers in other Asian markets to look to North America and Australia for coal supplies. Secondly, the North American coal market has also shown continued signs of strengthening as the United States economy continues its recovery from the mild recession of 2001 and 2002. With natural gas and oil prices continuing at the elevated levels first experienced in early 2002, a significant number of industrial consumers and electricity companies are switching back to the use of coal because of its lower price. Furthermore, as many people continue to believe that the North American natural gas market will remain in short supply, industry is converting back to coal as a key energy source.

Core Coal Sales

Our core business consists of the supply of thermal coal by barge from the Middle Point facility to a number of local cement and industrial customers. We achieved four very important accomplishments in 2003. One of the Pacific Northwest's largest cement companies awarded Quinsam Coal a two year supply contract commencing in 2004 for its plants in Vancouver, B.C. and Seattle, Washington. Commercial deliveries commenced in December 2003. Regular commercial sales to this company have continued into the first quarter of this year.

With the increase in the international price for sea-borne coal, we were successful in concluding a total of four ship load sales into the spot market, three of which will be recorded as sales in 2004. We have also seen increased interest from the greenhouse industry in using coal as its primary heating fuel. Higher natural gas prices have significantly increased operating costs in this highly competitive industry. We expect that our sales to the green house customers will increase significantly in 2004 over sales levels from previous years.

The efficient transportation of coal is a key factor in the competitiveness of any coal company. We are pleased to report that in early 2004 we were successful in finalizing an agreement to purchase the Middle Point barge loading assets from the British Columbia Government. This transaction is expected to close on or about April 1, 2004. Approval from Transport Canada is a condition precedent to closing. The control of this facility will immediately reduce our transportation costs and provide the potential for moving other commodities through Middle Point.

Operations, Safety and the Environment

Mining activities were uneventful in 2003. In 2003, mining resumed to the interior of the coal seam which provided the expected benefit of higher yields from the preparation plant. The yield increased to over 70 per cent from the mid 60 percent range experienced in 2002. As a result of this increase in production, Quinsam took a one month closure in mid summer to allow all employees vacation leave and to facilitate the management of our working capital. We expect that with the higher rate of sales in 2004, the Quinsam Mine will be required

to operate the entire year at a rate of production forecast at roughly 35,000 tonnes per month. Quinsam values the excellent relationship it has with its employees. The collective bargaining agreement expired in 2003. The company successfully negotiated a four year agreement with the union which is fair to both the employees and the shareholders of the company.

The health and safety of our employees remains a very important priority for management and the workers. Quinsam continued with an excellent safety record in 2003, finishing the year with no lost time accidents. In 2003, Quinsam was again awarded, for the fifth consecutive year the B.C. Small Mines Underground Safety Award. We believe this record of continuous achievement is without precedent. Our objective of being accident free remains a key part of our operating philosophy.

Quinsam continues to maintain an exemplary environmental record. There were no non compliant events in 2003. To ensure the company operates to the highest possibly standards, Quinsam invested almost $600,000 to modernize and enhance its environmental protection systems.

Exploration

In 2003, we expended approximately $170,000 on various exploration activities. Almost 50% of that amount was spent to further define the resources in the 4 South Area. As well, we continued to advance its search for a local source of magnetite which is used in the production of clean coal.

Coal Bed Methane

In early 2003, the Government of British enacted the Coal Bed Gas Act under which the Government effectively claimed ownership of any coal bed methane contained within the freehold coal owned by Quinsam coal. Since the enactment of this legislation the company has been in negotiations with the B.C. Government to regain title to the methane within its owned coal resources. It has been the position of Hillsborough that title to coal bed methane rightly rests with the owner of the coal resource. While a definitive agreement with the government has not been signed, progress on this dispute has been excellent. The Company believes an agreement may be reached with the British Columbia Government in early 2004. In anticipation of obtaining title to the coal bed methane we have undertaken a significant amount of work to expedite our drilling.

Power Project

In 2003, the British Columbia Utilities Commission ("BCUC") held public hearings to review the application by B.C. Hydro to construct a 265 MW gas fired combined cycle gas turbine plant on Vancouver Island. We believe strongly that a coal fired mine mouth power plant, using Quinsam's coal is a superior alternative than that put forth by B.C. Hydro and some of the other participants in the hearings. Therefore, management of Hillsborough actively intervened in the hearings with the result that the BCUC denied the application by B.C. Hydro to proceed with the gas plant at Nanaimo. The BCUC directed B.C. Hydro to proceed with a tender process to identify alternative means of meeting Vancouver Island's electricity needs. In order to strengthen Hillsborough's chances of being successful in this tender, we entered into a partnership with Cinergy Solutions, Inc., a subsidiary of a very large U.S. based utility. This partner has both the technical and financial capabilities to build and operate a coal fired power plant using state of the art technology. It is proposed that we will participate in this tender, which is ongoing at this time. Our plan is to build a 165 MW coal fired power plant which will be 50% owned by Hillsborough. Quinsam Coal will agree to supply the plant with coal under market related prices.

Outlook

I believe that 2004 will be a profitable and positive year for Hillsborough Resources Limited. The Company has secured a large and profitable core base of sales into the Pacific Northwest and a substantial volume of spot sales at very favourable prices. As I mentioned, we have already concluded a number of spot sales for 2004 and anticipate more in 2005. While no guarantees can be given on the successful outcome of the power project and the coal bed methane activities, we believe Hillsborough has positioned itself for a successful outcome in one or both of these endeavors.

Acknowledgements

In conclusion, I would like to thank all of our shareholders for remaining supportive of our efforts to grow your company. In 2004 we will continue to work hard to improve the cost competitiveness of our operations and work to successfully advance those projects that are in the development stage. I would also like to thank our customers who have remained loyal to Quinsam Coal and our employees for their dedication and support over the past year.

Respectfully Yours,

David J. Slater
President and CEO

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the audited consolidated financial statements and accompanying notes of Hillsborough Resources Limited ("the Company") which have been prepared in accordance with generally accepted accounting principles in Canada.

This discussion is at March 29, 2004. The results for 2001 have been restated to reflect the change, effective January 1, 2002, in the Company's revenue recognition policy. All currency in this discussion is in Canadian dollars.

Critical Accounting Estimates

The most significant accounting estimates made include the carrying value of property, plant and equipment and the ultimate cost of reclamation and site restoration. Property, plant and equipment is carried at cost less accumulated depreciation and write downs. At least annually management estimates the future cash flow expected to be generated from mining operations. If this estimate is less than the carrying value of property, plant and equipment an appropriate charge to earnings is taken. The estimate of future cash flow requires estimates of the mineability and cost of the coal reserves and resources, future coal prices, foreign exchange rates and the consumption patterns of critical customers.

Management must also estimate the cost of reclamation and site restoration. These estimates are based upon internal engineering studies which are reviewed by external consultants. These estimates rely on future labour and equipment operating costs and they assume that there will be no major change in applicable environmental laws and regulations.

Changes in Accounting Policies

In 2003, the Company adopted the CICA standard for accounting for stock based compensation and other stock based payments. In order to estimate the expense of such awards, the Company uses the Black-Scholes option pricing model. In 2003, the cost of adopting this policy was insignificant. The Company is unable to estimate the impact this policy will have in the future because such awards are at the discretion of the Board of Directors and are dependant on the performance of the Company and the performance of the individual eligible for the award.

The Company expects to adopt the new CICA standard for accounting for asset retirement obligations in 2004. At this time, the impact of the adoption of this policy cannot be estimated with any reasonable degree of certainty.

Use of Financial Instruments

The Company does not employ any financial instruments, except insurance and minimal currency hedging to mitigate risk. The insurance obtained is property and liability insurance. Due to the cost of business interruption insurance, the Company has not obtained this type of coverage. The Company may hedge certain coal sales revenue which is denominated in US dollars. It is the policy of the Company to match these hedges to the receipt of sales revenue. Typically less than 30% of sales revenue is denominated in currencies other than the Canadian dollar and the currency hedges, if any, generally have a maturity of less than one year. Therefore this activity is not believed to have a material impact on the underlying financial results of the Company.

Results of Operations-Full Year

In 2003, the Company produced 454,058 tonnes of raw coal as compared to 519,396 tonnes of raw coal in 2002 and 474,327 tonnes in 2001. Raw coal production declined by 13% in 2003 as compared to 2002 because operations at the mine were temporarily suspended for a six week period to facilitate employee vacations and to assist in the management of the Company's clean coal inventories. Production rates were increased in 2002 over 2001 by 9.5% to ensure that adequate clean coal was available to meet a planned increase in coal sales targeted to the international spot market. The Company will continue to adjust its raw and clean coal production in response to prices and demand in the international spot market and the requirements of its domestic customers.

Clean coal production in 2003 was 312,267 tonnes with a yield from the preparation plant of 70.8%. In 2002, clean coal production totaled 341,432 tonnes with a 65.7% yield from the preparation plant. In 2001, clean coal production was 314,483 tonnes with a yield of 66.3%. Yields have increased over the past three years because, in prior years, there was a higher percentage of ash in the raw coal due to the quality of the coal seams being mined. The yields experienced in 2003 are at normal levels and further increases in yield are not expected.

In 2003, the cost per tonne of clean coal sold was $39.36, which was lower than 2002 because of lower transportation costs associated with the reduction in spot sales. In 2002, the cost per tonne of clean coal sold was $39.57 versus $34.89 in 2001. This 13.4% increase in coal production costs was due to the increased transportation costs arising from the increased sales into the spot market and higher operating costs at the mine. In 2001, the ratio of depillared coal production compared to development coal production was higher than in 2003 and 2002. Cost of producing depillar coal is less than that of development coal.

In 2003, Quinsam Coal Corporation received the B.C. Underground Miners safety award for the fifth consecutive year. In addition, its environmental performance was excellent with no reportable incidents.

Earnings and Financial Performance

In 2003, Hillsborough sold 284,371 tonnes of clean coal compared to 395,619 tonnes in 2002 and 226,413 tonnes in 2001. The 28% decline in sales between 2003 and 2002 was due to management's decision to substantially reduce sales into the international spot market. The company's core contractual domestic business in 2003 was at levels slightly greater than 2002 because of the addition of two new customers. In 2001, the company sold 226,413 tonnes mostly into the domestic market. The increase in sales volume in 2002 as compared to 2001 was due to an increase in sales in the export market combined with a small increase in sales volumes to domestic customers.

The average realized price of coal in 2003 was $47.36 per tonne compared to $45.47 per tonne in 2002 and $47.08 per tonne in 2001. The marginally higher average price in 2003 compared to 2002 was due to a higher percentage of sales in the higher margin domestic business partially offset by a higher Canadian dollar which translated into lower Canadian dollar realizations for those sales denominated in US currency. In 2003, approximately 37% of sales by volume (38% by revenue) were denominated in US dollars. In 2002 approximately 64% of sales by volume and revenue were denominated in US dollars.

Income from Coal Operations in 2003 was $2.27 million compared to $2.33 million in 2002 and $2.76 million in 2001. The marginal decline in income was due to the appreciation of the Canadian dollar which reduced the margin on those sales denominated in US dollars. Income from Coal Operations in 2001 benefited from a weaker Canadian dollar and lower production costs as previously described.

General and Administration costs in 2003 totaled $1.36 million compared to $1.57 million in 2002 and $1.28 million in 2001. The decline in spending in 2003 compared to 2002 was due to a reduction in spending on professional and consulting services. Depreciation, depletion and amortization costs in 2003 totaled $629,091, which was similar to the level expensed in 2002 of $683,713. In 2001, depreciation, depletion and amortization costs were $630,148. Depreciation, depletion and amortization was less in 2001 because of the lower level of production and sales. Interest expense in 2003 of $19,088 was below the levels of 2002 and 2001 which were $35,191 and $168,994, respectively. The year over year over year decline represents the gradual elimination of debt and overall strengthening of the Company's balance sheet. In 2001, the company repaid an outstanding convertible debenture and incurred interest expense on the debenture up until May. In 2003, the Company incurred severance obligations relating to two events. A severance dispute was settled related to a termination in 2001 and in 2003 additional severance obligations were paid to those employees that were not recalled to work following the temporary cessation of operations in July. In both 2003 and 2002, the Company did not incur any profit sharing payments to employees as stipulated in the collective bargaining agreement. In 2001, $56,129 was paid pursuant to a production bonus plan. The costs for creditor arrangements in 2003 and 2002 related primarily to ongoing administration payments to the court-appointed Monitor. This monitoring function ceased at the end of the third quarter of 2003. In 2001, the company incurred significant legal and accounting costs that related to the creditor protection filing of the previous year. With the expiration of the creditor payment obligations pursuant to the court approved plan, the unsecured creditor obligations totaling $682,557 were eliminated and reported as income in the third quarter of 2003.

In 2003, Other Income declined from $552,251 to $136,434. The main components in Other Income in 2003 included equipment rental income of $64,177, sales tax refunds on safety equipment of $76,766, interest income of $67,539, offset by a write down in the carrying value of an investment in a public company of $41,079 and a reduction in the carrying value of a receivable denominated in US dollars of $63,610. In 2002, Other Income was $552,251 compared to only $70,294 in 2001. The more significant components in Other Income in 2002 included $533,399 from the gain on sale of parts and equipment offset by a $278,083 reduction in the carrying value of the base pad coal inventory. In 2001, assets sales resulted in gains of $67,597 which was offset by asset write downs of $79,412. Foreign exchange gains and interest income in 2002 totaled $228,907 versus $156,058 in the prior year. Also in 2001, the Company wrote down the carrying value of its marketable securities by $196,463.

In 2003, the Company abandoned a mineral property and wrote off its remaining investment in it which totaled $7,184. In 2002, the Company was unable to renew its option on the T'Sable River coal property and as a result its investment of $731,318 was written off. There were no such charges to income in 2001.

Liquidity

As at December 31, 2003, the Company had cash on hand of $1.4 million compared to $3.2 million at the end of 2002 and $1.85 million at year end in 2001.Non cash working capital improved during the year by $2,065,348 (77%) to $4,762,842. In 2001, non-cash working capital was $4,612,277. The improvement in non-cash working capital was due to a $1,231,144 (44%) reduction in current liabilities and a $782,701 increase in inventories. The Company's cash and inventory levels may vary significantly from period to period because in the normal course of operations cash is converted into inventory as the Company increases its clean coal inventories in order to have sufficient coal available to load a ship.

In 2003, cash flow from operating activities was negative $0.5 million compared to $2.6 million in 2002 and negative $3.4 million in 2001. In 2003, coal inventories increased by $748,386 and payables, excluding the unsecured creditors, were reduced by $583,565. These working capital changes in 2003 totaled $1,331,951. In 2001, the Company was building coal inventories while in 2002 it was liquidating these same inventories.

The third party commitments the company has excluding closure and site restoration obligations at the Quinsam coal site and the Middle Point barge loading facility are presented below. Site remediation costs at Quinsam are secured by an $800,000 cash deposit and there is a $500,000 cash deposit securing various potential obligations at Middle Point.

The following table identifies those fixed commitments that the Company has entered into.

Year	Operating Leases	Conditional Sales Contracts
2004	$355,045	$18,127
2005	$234,566	$0
2006	$18,631	$0
2007	$10,264	$0
2008	$5,853	$0

The Company also has conditional commitments with a third party trucking company for which the Company pays a per tonne fee based upon the monthly volume of coal transported to Middle Point. As well, the Company pays to the British Columbia Transportation Financing Authority (The "BCTFA") a user fee based upon the number of tonnes of clean coal produced by the mine. This fee is to reimburse the BCTFA for its financing of the leasehold improvements at Middle Point. The user fee is a tonnage based payment related to international thermal coal benchmark prices and it is fixed annually each September.

Capital Resources

Net capital spending in 2003 on replacement capital was $1.4 million which was essentially the same as 2002 and marginally greater than the $1.3 million expended in 2001. In all years this level of capital spending has been financed from general working capital.

An agreement has been reached to acquire from the BCTFA the leasehold improvements at the Middle Point barge loading facility at a cost of $3.35 million plus the granting of 400,000 share purchase warrants. This acquisition will reduce the transportation costs associated with all coal sales by between $1.30 and $2.00 per tonne and the Company will have a $500,000 security deposit returned to it. Currently, the Company is attempting to secure debt financing to fund this acquisition; however, if such financing is not available under reasonable terms, then the Company may use a combination of working capital and sale of common shares to finalize the transaction.

In 2003, there was no material issuance of common stock. In 2002, the Company issued (into escrow) 682,680 common shares, valued at $395,954, to complete the acquisition of D and R Resources, Inc. Also in 2002, the Company acquired and cancelled 33,820 common shares at a cost of $13,243 pursuant to its normal course issuer bid.

As at December 31, 2003 and 2002, Hillsborough had no long term debt remaining. In 2001, Hillsborough received proceeds of $9.5 million from the sale of common equity. Of this amount, Hillsborough repaid $3.7 million of debt, including convertible debentures. The remainder was used to reduce trade payables and for other general working capital requirements.

Fourth Quarter 2003

Hillsborough Resources Limited reported a very strong fourth quarter. Coal sales were 71,121 tonnes (2002: 87,990), all of which went into the higher margin domestic market. The average realized selling price in the fourth quarter of 2004 was $48.03 compared to an average price of $47.13 per tonne during the first nine months of 2003 and $45.80 during the fourth quarter of 2002. As a result, fourth quarter earnings were $419,216 (2002: a loss of $573,686). Total clean coal production in the fourth quarter was 66,312 tonnes (2002: 78,752).

Summary of Quarterly Results

Key financial and operating statistics for the most recent eight quarters is presented below:

Period	Sales ($)	Sales (t)	Rev/t	Income	Prod'n (t)	Prod'n Cost	Cost/t	EPS($)
2002-Q1	4,973,836	113,489	43.83	(22,178)	84,722	4,575,475	40.32	0.00
2002-Q2	5,901,071	132,049	44.69	(119,660)	79,678	5,317,551	40.27	0.00
2002-Q3	3,082,885	62,091	49.65	523,249	98,280	2,499,098	40.25	0.02
2002-Q4	4,029,652	87,990	45.80	(573,686)	78,752	3,261,537	37.07	(0.03)
Subtotal	**17,987,444**	**395,619**	**45.47**	**(192,275)**	**341,432**	**15,653,661**	**39.57**	**(0.01)**
2003-Q1	3,236,325	65,523	49.39	(37,034)	104,610	2,849,922	43.49	0.00
2003-Q2	4,471,710	99,329	45.02	(60,099)	110,335	3,785,181	38.11	0.00
2003-Q3	2,343,081	48,398	48.41	597,246	31,010	1,955,426	40.40	0.02
2003-Q4	3,415,895	71,121	48.03	419,216	66,312	2,602,157	36.59	0.01
Subtotal	**13,467,011**	**284,371**	**47.36**	**919,329**	**312,267**	**11,192,686**	**39.36**	**0.03**

The reader should be aware that while past history may be reflective of certain trends, it is not an overly reliable predictor of the future. This is because the interrelationship among production volumes, production costs, the mix between spot and contractual sales, and the prevailing spot price and foreign exchange rates will all interact to result in a unique financial performance for the period being considered.

In analyzing sales, the main factor influencing the sales volume is whether or not a spot sale is recorded in that specific quarter. This is true for all periods except the final quarter of 2003, in which all sales were into the domestic market. In 2003, two new domestic customers commenced coal purchases. Prior to that, the approximate volume of domestic sales was 230,000 tonnes per year. Currently, domestic sales are expected to approximate 360,000 tonnes per year. In the past, spot realizations (which are denominated in US dollars) have been well below domestic realizations. This resulted in lower realized prices when spot sales were recognized in a reporting period. Net income has been affected by unique items, most notably in the third quarter of both 2002 and 2003. These events were the sale of parts and equipment in 2002 and the reversal of creditor liabilities in 2003.

In general, prudent mining practices demand a relatively consistent rate of production. This allows for better mine development and a more efficient labor force. Therefore, a smooth production profile will result in a somewhat consistent level of production costs, with the actual costs impacted by the allocation of fixed costs over that level of production and also by the ratio of development coal to de-pillar coal. De-pillar coal is lower cost than production coal. Yields from the wash plant will also impact the final cost of clean coal produced. Because of the need to smooth production, the Company will typically build inventories in anticipation of loading between 45,000 tonnes and 70,000 tonnes for a given spot sale in any month.

Selected Annual Information

Key financial and operating data for the past three years is presented below.

	2003	2002	2001
Coal sales ($)	13,467,011	17,987,444	10,659,328
Coal sales (mt)	284,371	395,619	226,413
Net Income ($)	919,329	(192,275)	313,138
Revenue per tonne ($)	47.36	45.47	47.08
Cost per tonne ($)	39.36	39.57	34.89
Earnings per share (basic)	0.03	(0.01)	0.02
Earnings per share (diluted)	0.03	(0.01)	0.01
Total Assets ($)	16,809,950	17,133,064	16,953,443
LT Liabilities ($)	287,463	300,094	810,401
Dividends per share ($)	0	0	0

Coal sales vary from period to period depending upon the number of tonnes the company sells into the international spot market. In 2001, almost all sales were into the domestic market, however in 2002, the company made three sales into the export market. 2003 sales were mainly in to the domestic market, but there was a small spot sale in the first quarter. Selling and transportation costs into the spot market are higher than for the domestic sales. This explains the higher cost per tonne in 2002 and 2003. The Company's ability to sell into the spot market is dependant upon the quality expectations of its customers, the prevailing U.S. dollar denominated spot price, and the foreign exchange rate. In 2003, the spot coal market was depressed and with the Canadian dollar strengthening the Company did not make any incremental spot sales.

In 2003, earnings benefited by $682,557 when certain creditor liabilities expired and their reversal were recorded as income. In 2002, earnings were enhanced by a $533,399 gain on the sale of certain parts and equipment. This gain was offset by a write down of $731,318 on a development property for which the Company was unable to extend its mining lease. In 2003 and 2002, the only long term liabilities were for site reclamation and restoration expenses. These liabilities are secured by cash held on deposit with a major financial institution. In 2001, the long term liabilities consisted of reclamation and site restoration costs and certain unsecured creditor liabilities.

The Company has not paid any dividends and does not expect to pay any in the near future.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Related Party Transactions

In 2003 the Company paid $289,447 to three companies which are related to directors of the Company. Management does not believe these payments are material to the Company or the companies to which the directors are related. The payments were made for legal services, engineering consulting services on the power project and for transportation services to deliver coal to a customer.

Outlook

The following information is forward looking in nature and as such actual results may differ materially from the expectations of management. Events which may cause these results to differ from those results identified below may include, but are not limited by, unexpected increases in the costs of producing coal, changes in international coal or transportation markets, a rapid appreciation of the Canadian dollar versus the US dollar, and a fundamental slow down in the North American or Asian economies.

The Company anticipates that domestic coal sales volumes in 2004 will increase significantly over 2003 levels. There are two important reasons for this. The Company was able to secure a two year sales contract with a major cement company in the Pacific Northwest. Also, the recent rapid increase in the international spot coal prices has facilitated the Company's successful re-entry into that market.

The company anticipates that in 2004 sales will range between 500,000 and 520, 000 tonnes; an increase of approximately 80% over 2003 sales. Almost all sales are contractual or firm commitments. With this increase in sales, the Company will be increasing the annualized rate of production at the Quinsam mine beginning in the second quarter of 2004 to approximately 460,000 tonnes. Approximately 30% of sales in 2004 will be into the spot market.

Normal replacement capital spending in 2004 is expected to remain at approximately the same level of spending as in 2002 and 2001. In addition, the Company contemplates the closing of the acquisition of the leasehold improvements associated with the Middle Point barge loading facility on or about April 1, 2004 at a cost of $3.35 million plus the issuance of 400,000 share purchase warrants.

The Company will continue to participate, with its partner, in the Vancouver Island Call For Tenders conducted by B.C. Hydro. This is a competitive tender process for the provision of electricity on Vancouver Island. The Company can give no assurance that these efforts will be successful. The Company also believes that it will be successful in securing title to the coal bed methane rights within its freehold coal holdings during 2004. The success of this is dependant upon negotiations with the Government of British Columbia.

Miscellaneous Information

The Company has filed its Annual Information Return for the 2002 fiscal year on SEDAR and it will file an updated version for 2003.

As at this date, the company has 32,181,511 shares outstanding, of which 682,680 were held in escrow. In addition, there are 2,000,000 share purchase warrants and 1,951,500 stock options outstanding. If the purchase of the Middle Point barging facility is completed on or about April 1, 2004, an additional 400,000 share purchase warrants will be issued.

Hillsborough Resources Limited

Consolidated Financial Statements
December 31, 2003 and 2002

Together with Management Responsibility Letter
and Auditors' Report

To the Shareholders of Hillsborough Resources Limited (the "Company"):

The accompanying consolidated financial statements of the Company were prepared by management in accordance with accounting principles generally accepted in Canada, and within the framework of the summary of significant accounting policies in the notes to these financial statements. Management is responsible for all information in the Annual Report. All financial and operating data in the Annual Report is consistent, where appropriate, with that contained in the consolidated financial statements.

A system of accounting and control is maintained in order to provide reasonable assurance that the assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorization. The system includes established policies and procedures, the selection and training of qualified persons as is reasonably possible, and an organization providing for the appropriate delegation of authority and segregation of responsibilities for a company of the size of Hillsborough Resources Limited.

The Board of Directors discharges its responsibilities for the consolidated financial statements primarily through the activities of its Audit Committee composed of three directors. This Committee meets with management and the Company's independent auditors to assure that it is performing its responsibility to maintain financial controls and systems and to approve all financial information released to the public. The Audit Committee also meets with the independent auditors to discuss the scope and the results of the audit and the audit report prior to submitting the financial statements to the Board of Directors for approval.

The consolidated financial statements for 2003 and 2002 have been audited on behalf of the shareholders by the Company's independent auditors, PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards. The auditors report outlines the scope of their audit and their opinion on these consolidated financial statements.

D.J. Slater
President and C.E.O

Scott M. Brunsdon
Vice President Finance and Corporate Development

February 27, 2004

To the Shareholders of Hillsborough Resources Limited:

We have audited the consolidated balance sheets of HILLSBOROUGH RESOURCES LIMITED (the "Company") as at December 31, 2003 and 2002 and the consolidated statements of operations and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, British Columbia

February 27, 2004

CONSOLIDATED BALANCE SHEETS

As at December 31	2003	2002
	$	$
ASSETS		
Current Assets		
Cash and cash equivalents	1,380,514	3,177,569
Marketable securities	30,362	71,441
Receivables	1,340,423	1,407,659
Inventories (Note 3)	4,534,337	3,751,636
Prepaid expenses	291,019	131,315
Asset held for sale	118,606	118,492
	7,695,261	**8,658,112**
Property, Plant and Equipment (Note 4)	**7,516,535**	**6,704,586**
Reclamation Deposits And Deferred Charges (Note 5)	**1,598,154**	**1,770,366**
	16,809,950	**17,133,064**
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	1,526,886	2,765,533
Current portion of lease obligations (Note 6)	18,127	–
Income and resource taxes payable (Note 10)	6,892	17,516
	1,551,905	**2,783,049**
Other Liabilities (Note 7)	**287,463**	**300,094**
	1,839,368	**3,083,143**
SHAREHOLDERS' EQUITY (NOTE 8)		
Capital stock	12,247,043	12,205,483
Warrants	200,000	200,000
Contributed surplus	1,713,593	1,755,153
Stock options granted	1,332	–
Retained earnings (deficit)	808,614	(110,715)
	14,970,582	**14,049,921**
	16,809,950	**17,133,064**

Approved by the Directors:

Win Stothert.

Winston D. Stothert, *Director*
Hillsborough Resources Limited

George W. Stuart, *Director*
Hillsborough Resources Limited

CONSOLIDATED STATEMENTS OF OPERATIONS

AND RETAINED EARNINGS (DEFICIT)

For the years ended December 31	2003	2002
	$	$
COAL REVENUES	13,467,011	17,987,444
Coal Production Expenses	11,192,686	15,653,661
INCOME FROM COAL OPERATIONS	**2,274,325**	**2,333,783**
EXPENSES (INCOME)		
General and administrative	1,362,750	1,567,144
Depreciation, depletion and amortization	629,091	683,713
Interest	19,088	35,191
Corporate restructuring	60,740	13,065
Creditor arrangements	5,914	5,548
Write-down of mineral properties	7,184	731,318
Write-down of marketable securities	41,079	–
Reversal of unsecured liabilities (Note 7)	(682,557)	–
Other income, net (Note 9)	(136,434)	(552,251)
	1,306,885	**2,483,728**
Income (Loss) Before Provision for Taxes	**967,470**	**(149,945)**
Provision for Taxes (Note 10)	**48,141**	**42,330**
NET INCOME (LOSS)	**919,329**	**(192,275)**
Retained Earnings (Defecit), beginning of year	**(110,715)**	**81,560**
Net income (Loss)	**919,329**	**(192,275)**
RETAINED EARNINGS (DEFICIT), end of year	**808,614**	**(110,715)**
Earnings (Loss) per Share (Note 11)		
Basic	0.03	(0.01)
Diluted	0.03	(0.01)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31	2003	2002
	$	$
OPERATING ACTIVITIES		
Net income (loss)	919,329	(192,275)
Items not affecting cash		
• Depreciation, depletion and amortization	629,091	683,713
• Stock option grant expense	1,332	–
• Write-down of mineral properties	7,184	731,318
• Write-down of marketable securities	41,079	–
• Reversal of unsecured liabilities (Note 7)	(682,557)	–
• Write-down of base pad inventories	–	278,083
• Loss (Gain) on disposal of capital assets, net	1,308	(269,293)
• Gain on sale of parts	–	(264,106)
• Reclamation provision	14,845	17,141
	931,611	**984,581**
Changes in non-cash operating accounts (Note 14)	(1,469,472)	1,602,991
	(537,861)	**2,587,572**
INVESTING ACTIVITIES		
Capital asset additions	(1,446,654)	(1,423,965)
Change in reclamation deposits and deferred charges	169,333	(39,604)
Proceeds from disposal of capital assets	–	449,501
	(1,277,321)	**(1,014,068)**
FINANCING ACTIVITIES (Note 7 and 8)		
Loans and lease obligation payments (decrease)	18,127	(233,776)
Shares issued for exercised stock options	–	–
Shares repurchased and cancelled	–	(13,243)
	18,127	**(247,019)**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(1,797,055)**	**1,326,485**
Cash and Cash Equivalents, beginning of year	**3,177,569**	**1,851,084**
CASH AND CASH EQUIVALENTS, end of year	**1,380,514**	**3,177,569**
Cash flows include the following elements:		
Income and resource taxes paid	**56,000**	**218,000**
Interest paid	**19,000**	**35,000**

1. BASIS OF PRESENTATION

a. Nature of Operations

These consolidated financial statements include the accounts of Hillsborough Resources Limited (Hillsborough), its wholly-owned subsidiaries, Quinsam Coal Corporation, T'Sable River Coal Corporation, D and R Resources Inc. and G H Fuels Limited, and its wholly-owned inactive subsidiaries, CBL Acquisition Corp., Mine Services International Inc., Can-Am Airlines Inc. and American Dorset Inc. (collectively referred to as the Company).The Company is engaged in the exploration for, the development of and the operation of coal properties, primarily targeted to the thermal or industrial coal markets. Investigations are underway toward developing coal bed methane resources and also to develop, in conjunction with a partner, a coal fired electricity plant captive to its owned or licensed coal resources.

b. Basis of Presentation

The consolidated financial statements are presented in accordance with generally accepted accounting principles applicable in Canada as typically applied in the mining and exploration industry. These statements include the accounts of all of the Company's subsidiaries and all inter-company transactions have been eliminated.

The Canadian dollar is the Company's reporting currency and the currency of measurement for all financial transactions reported in these financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and the valuation of assets and liabilities, reserves and expenses and the disclosure of contingent assets and liabilities. Significant estimates made include the carrying values of property, plant and equipment, depreciation rates, future income tax assets or liabilities, future environmental obligations and site restoration costs. Actual results may differ from those estimates made by management.

b) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits, and guaranteed investment certificates with maturities at the date of purchase of three months or less.

c) Marketable Securities

Marketable securities are recorded at the lower of cost and fair market value.

d) Coal Inventory

Raw coal inventory and clean coal inventory are valued at the lower of average cost and net realizable value.

e) Supplies Inventory

Supplies inventory is recorded at the lower of average cost and net realizable value.

f) Property, Plant and Equipment

Quinsam Coal Mine

Buildings, plant and equipment are recorded at cost less accumulated depreciation, depletion and write-downs. Depreciation for buildings and plant is provided on the straight-line method based on the estimated useful lives of the assets according to the current mine plan. Depreciation for equipment is provided on the declining-balance method based on the estimated useful lives of the assets. The depreciation rates range from 5 percent to 50 percent. Depletion of mine development costs is provided over the estimated life of the mine on a units of production basis using the current mine plan.

Exploration mineral properties

Investments in exploration mineral properties are recorded at cost. All costs of acquiring mineral properties are capitalized and related costs of financing, including interest, and exploration and development costs are deferred on a project basis. When a property is put into commercial production, the related investment is amortized on the units of production method. If the carrying value exceeds the anticipated net recoverable amount, the excess is charged to earnings.

If a project is abandoned, the entire investment is charged to earnings. The recovery of the carrying amount of mineral properties in the exploration stage is dependent upon the future commercial success of the related property or the proceeds from its disposition.

Contracting and Administrative assets

Contracting and Administrative assets are recorded at cost. Depreciation is provided using the declining-balance method over the estimated useful lives of the assets. The rates applied to the principal classes of depreciable assets are as follows:

Buildings	5%
Furniture and fixtures	20%
Equipment	30% to 50%

g) Reclamation Deposits and Deferred Charges

The deposits primarily consist of interest bearing funds deposited with financial institutions as security for agreements required for future environmental obligations, mining permits or other business related activities.

h) Revenue Recognition

Coal revenue is recognized when a sale of coal is contractually entered into and risk to and title of the coal has passed to the buyer.

i) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Temporary differences arising from the difference between the tax basis of an asset and a liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax

assets or liabilities are calculated using tax rates anticipated to be in effect in the periods that the temporary differences are expected to be settled or realized. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

j) Foreign Currency Translation

Sales and trade transactions denominated in foreign currencies are recorded in Canadian dollars at the exchange rate prevailing at the time of the transaction. Foreign exchange gains and losses are treated as a component of the related transaction and are included in earnings or capitalized accordingly.

Monetary assets and liabilities denominated in foreign currencies are converted into Canadian dollars at the exchange rate prevailing at the balance sheet date. Gains and losses are included in Other Income.

k) Reclamation and Site Restoration Costs

Provisions for estimated reclamation, site restoration, and other closure costs are charged against income using the unit-of-production method based upon the existing mine plan commencing when a reasonably accurate estimate of the cost can be made. Ongoing reclamation activities are charged to earnings as incurred unless previously accrued.

l) Financial Instruments

The Company's financial instruments consist of guaranteed investment certificates, marketable securities, receivables, accounts payable, loans and lease obligations, and other liabilities. Management estimates that the fair values of these financial instruments approximate their carrying values, unless otherwise noted.

m) Hedging Transactions

The Company does not hedge the price of its coal production. Some coal contracts are denominated in currency other than the Canadian dollar. The Company may enter into a foreign exchange contract to fix the exchange rate on these anticipated sales. If the sale does not materialize on the date that the foreign exchange contract matures the gain or loss is reported in Other Income.

n) Earnings per share

Earnings per share are calculated using the weighted average number of shares outstanding. The Treasury Stock method is used to calculate diluted earnings per share. Under this method, dilution is calculated based upon the net number of shares issued assuming "in-the-money" options are exercised and the proceeds are used to repurchase issued and outstanding common shares at the weighted average trading price for the period.

3. INVENTORIES

	2003	2002
	$	$
Coal	3,945,054	3,196,668
Supplies	589,283	554,968
	4,534,337	**3,751,636**

4. PROPERTY, PLANT and EQUIPMENT

	2003	2002
	$	$
Producing mining properties		
Quinsam Coal Mine		
• Land, buildings, plant and equipment	35,826,638	34,894,863
• Exploration, development and other	1,056,356	678,130
	36,882,994	**35,572,993**
Exploration mineral properties	**4,505,912**	**4,395,532**
Other	**348,323**	**329,253**
Contracting and administrative assets		
• Equipment	3,201,414	3,201,414
• Furniture and fixtures	163,482	163,482
	3,364,896	**3,364,896**
	45,102,125	**43,662,674**
Less accumulated depreciation, depletion and amortization		
• Producing mining properties	15,942,515	15,545,862
• Contracting and administrative assets	2,621,179	2,397,513
	18,563,694	**17,943,375**
Less Cumulative write-downs	**19,021,896**	**19,014,713**
Net Property, Plant and Equipment	**7,516,535**	**6,704,586**

The following table illustrates the net book value by category:

Category	Consolidated ($)
Land	1,550,026
Plant and equipment	3,554,890
Exploration & Development	871,682
Other Properties	447,897
Other	348,323
Equipment	731,097
Furniture	12,620
TOTALS	**7,516,535**

Exploration Mineral Properties

In 2002, the Company acquired D and R Resources Inc. by issuing 682,680 common shares which remain in escrow pending the satisfaction of certain conditions. The escrow period has expired with certain conditions not being satisfied. The company is currently in discussions with the former owners of D and R Resources Inc. to determine if the escrow period should be extended. The allocation of the assets owned by D and R Resources Inc. is more fully described in Note 14 (b).

5. RECLAMATION DEPOSITS AND DEFERRED CHARGES

	2003	2002
	$	$
Guaranteed investment certificates	1,494,000	1,653,000
Other	104,154	117,366
	1,598,154	**1,770,366**

The guaranteed investment certificates have been lodged as security for mining permits and other obligations.

6. LEASE OBLIGATIONS

	2003	2002
	$	$
Obligations under capital leases of equipment	–	–
	–	–
Current portion of lease obligations	18,127	–

There is a conditional sales contract for the purchase of a piece of equipment used in the mining operations which is payable by December 31, 2004 and has an interest rate of prime plus 1.5%

7. OTHER LIABILITIES

	2003	2002
	$	$
User fees on coal facilities	–	27,476
Reclamation and site restoration	287,463	272,618
	287,463	**300,094**

Unsecured creditors

As at December 31, 2003, the Company has nil (2002–$682,557) recorded as liabilities in respect of Quinsam's unsecured creditor claims resulting from the CCAA order made in 2000. The obligation to repay the amount outstanding at the end of 2002 expired on September 30, 2003 and this amount was recorded as Income.

User fees on coal facilities

As at December 31, 2003, the Company has $27,476 (2002–$137,383) recorded in respect of usage fees on coal facilities. Of this amount, $27,476 (2002–$109,907) is presented in accounts payable on the balance sheet. In 2002, $27,476 was presented as a long-term liability.

8. CAPITAL STOCK

	Number of Shares	Amount
Authorized		$
Unlimited number of common shares (without par value)		
Issued and outstanding		
Balance, December 31, 2001	29,032,868	11,864,942
Issued for acquisition, held in escrow	682,680	395,954
Shares repurchased and cancelled	(33,820)	(55,413)
Balance December 31, 2002	29,681,728	12,205,483
Adjustment for issuer bid	–	41,560
Correction for rounding of fractional shares	63	–
Balance, December 31, 2003	**29,681,791**	**12,247,043**

On August 20, 2002 the Company initiated a normal course issuer bid which continued until August 19, 2003. In 2002, the Company purchased and cancelled 33,820 common shares at a cost of $13,243. No shares were repurchased in 2003.

A Director and Employee Incentive Stock Option and Share Compensation Plan (the "Plan"), approved by the shareholders of the Company, allows the Compensation Committee of the Board of Directors, to make grants of options and stock appreciation rights to directors and key employees to purchase common shares of the Company. Under the Plan, the aggregate number of common shares reserved for issuance at the date of grant of any option cannot exceed 3.4 million common shares. The option price will be determined

by the Board of Directors at the time an option is granted, however, the exercise price of the option will not be less than the market price of the common shares on the date of grant. The term of the award shall be for ten years from the date of the grant and all grants vest either immediately or within 24 months.

There were stock options representing the purchase of 10,000 common shares of the Company granted during 2003. The status of stock options granted to employees and directors as at December 31, 2003 and 2002 and any changes during the year then ended is presented below:

	2003		2002	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding, beginning of year	1,998,000	0.42	1,680,500	0.39
Issued	10,000	0.27	407,500	0.53
Exercised	–	–	–	–
Forfeited	(56,500)	0.90	(90,000)	0.38
Expired	–	–	–	–
Options outstanding, end of year	**1,951,500**	**0.41**	**1,998,000**	**0.42**

As at December 31, 2003, the Company has 1,951,500 (2002 – 1,998,000) options outstanding at the following prices:

Exercise Price	Expiry Date	Options Outstanding	Number Vested	Weighted Average Exercise Price
$0.00 – $0.09	2009	200,000	200,000	$0.07
$0.10 – $0.19	2009	400,000	400,000	$0.10
$0.20 – $0.29	2013	10,000	10,000	$0.27
$0.30 – $0.39	2011	630,000	630,000	$0.35
$0.40 – $0.49	–	–	–	–
$0.50 – $0.59	2012	407,500	355,000	$0.53
$0.60 – $0.69	2011	20,000	20,000	$0.60
$0.70 – $0.79	–	–	–	–
$0.80 – $0.89	–	–	–	–
$0.90 – $0.99	2011	20,000	20,000	$0.97
$1.00	2008	264,000	264,000	$1.00
		1,951,500	1,899,000	$0.41

In 2002, the Company adopted the CICA standard, "Accounting for Stock-based Compensation and Other Stock-Based Payments". As the equity awards granted by the company consisted solely of options, the Company has chosen to disclose the fair market value estimate of these options. The disclosure includes the estimated fair market value of 100% of the options granted. For 2003, the estimated fair market value of options granted to employees was $1,332 (2002–$109,457). To estimate this fair market value of the options granted, the Black-Scholes option valuation model was used. The following assumptions were employed to estimate fair market value. Theses assumptions are subject to considerable uncertainty and need to be reassessed for each separate grant of options.

a) Exercise price:	market at the time of the grant
b) Average Life of Option:	3.28 years, based upon historical evidence
c) Estimated Volatility:	67%
d) Interest Rate:	4.3%
e) Dividends:	none

Warrants

At December 31, 2003, the Company had 4,000,000 (2002–4,000,000) share purchase warrants outstanding to acquire common shares of the Company at $0.36 per share. These warrants are exercisable at any time prior to October 6, 2005. Also at December 31, 2003, the Company had 499,720 (2002–499,720) share purchase warrants outstanding to acquire 499,720 common shares at $0.36 per common share. These warrants are exercisable at any time prior to October 6, 2006.

9. OTHER INCOME (EXPENSE)

	2003	2002
	$	$
Interest	67,539	82,355
Foreign Exchange	(63,610)	146,553
Coal Pad Write-down	–	(278,083)
Gain (loss) on Asset Disposal	(1,308)	269,293
Gain on Sale of Parts	–	264,106
Rental Income	67,635	–
Miscellaneous	66,178	68,027
Other Income	**136,434**	**552,251**

10. PROVISION FOR INCOME AND RESOURCE TAXES

	2003	2002
	$	$
Provision for current income and resource taxes	48,141	42,330
Provision for future income taxes	–	–
Provision for income and resource taxes	**48,141**	**42,330**

The provision for (recovery of) income and resource taxes is analyzed in the following table to show the taxes that would be payable by applying statutory tax rates to the Company's pre-tax earnings and the taxes actually provided in the accounts.

	2003	2002
	$	$
Income before provision for income and resource taxes	967,470	(149,945)
Combined statutory tax rates	**38%**	**40%**
Expected tax provision (recovery) at statutory rate	367,639	(59,978)
Adjust for tax effect of		
Non deductible differences	(23,719)	(72,087)
Tax assets utilized	(631,568)	(624,280)
Resource and large corporation taxes	48,141	42,330
Tax assets not recognized	287,648	756,345
Provision for income and resource taxes	**48,141**	**42,330**

At December 31, 2003, the Company has tax loss carryforwards of approximately $3.2 million, of which $0.1 million expires in 2004, $0.1 million expires in 2006, $1.6 million expires in 2007 and $1.0 million expires in 2009 and $0.4 million expires in 2010. In addition, the Company has approximately $56.8 million of deductible temporary differences (includes approximately $24.8 million of resource deductions, of which $7.5 million are from predecessor companies and the value of these benefits may not be realizable).The Company has taken a full valuation allowance in respect of these amounts, and accordingly, no future income tax asset has been recognized in these financial statements.

Temporary differences and tax loss carryforwards that give rise to potential future income tax assets as at December 31, 2003 and 2002 are described below.

Future Income Tax Assets

	2003	2002
	$	$
Tax loss carry forwards and other amounts	1,483,889	1,093,302
Tax values of assets in excess of carrying values	17,084,068	14,471,481
Total future income tax assets	18,567,957	15,564,783
Valuation allowance	(18,567,957)	(15,564,783)
Future income tax assets	–	–

11. EARNINGS PER SHARE

Earnings (loss) per share have been calculated based on the weighted average number of shares outstanding during the year ending December 31, 2003 of 29,681,752 (2002–29,158,125). Fully diluted earnings per share for the year ending December 31, 2003 were $0.03. The weighted average number of shares outstanding on a fully diluted basis in 2003 was 30,148,517 and 30,810,208 in 2002.

12.. COMMITMENTS

(a) During 1996, Quinsam managed the construction of a coal transportation, storage and loading facilities all located at the Middle Point terminal near Campbell River, B.C. These improvements are owned by the British Columbia Transportation Authority (BCTFA) and the BCTFA provided Quinsam with financing of $9.0 million to complete these improvements. Pursuant to a Project User Agreement, Quinsam has agreed to pay for the use of the facilities by way of a monthly usage fee determined by the volume of clean coal transported from the mine site for the period from September 1, 1996 to August 31, 2011.

(b) Quinsam entered into a haulage contract with a company to transport coal from the Quinsam mine site to the storage and loading facility at Middle Point for the period from January 1, 1996 to December 31, 2005.

(c) Under the terms of a Profit Sharing Plan with its employees, Quinsam was obligated to pay 10 percent of its net profits from coal operations (as defined) during each fiscal year until the expiration of the collective bargaining agreement in April 2003. Under the recently concluded four year collective bargaining agreement the profit sharing obligation has been eliminated. The collective bargaining agreement expires April 30, 2007.

(d) The company has 10 pieces of equipment under operating leases with the leases expiring between 2005 and 2008. Estimated lease payments are as follows: 2004–$355,045; 2005–$234,566; 2006–$18,631; 2007–$10,264; and 2008–$5,853.

As at December 31, 2003 there were no currency hedges outstanding; the mark to market value of the Company's foreign exchange contracts as at December 31, 2002 was $20,575.

13. RELATED PARTY TRANSACTIONS

In 2003, the Company paid $289,447 to three companies which are related to directors of the Company. Management does not believe these payments are material to the Company or to the companies to which the directors are related. The payments were made for legal services, engineering consulting services on the power project and for coal trucking services to a customer.

14. SUPPLEMENTARY CASH FLOW INFORMATION

a) Analysis of Change in Non Cash Working Capital

	2003	2002
	$	$
Receivables	67,236	(454,731)
Coal Inventory	(748,386)	1,631,286
Supplies Inventory	(34,315)	(60,235)
Assets Held for Sale	(114)	253,854
Prepaid Expenses	(159,704)	26,993
Payables and Accruals	(583,565)	369,258
Taxes Payable	(10,624)	(163,434)
(Decrease)/ Increase	**(1,469,472)**	**1,602,991**

b) Non Cash Investing and Financing Activities

Common shares issued for:	2003	2002
	$	$
Acquisition of mineral properties	–	318,521
Acquisition of depreciable assets	–	77,434
	–	**395,955**

15. SUBSEQUENT EVENTS

(a) On January 27, 2004, the Company entered into an agreement to assume the rights and obligations of the British Columbia Transportation Financing Authority (the "BCTFA") respecting the lease and leasehold improvements at the Middle Point barge loading facility. The Company has agreed to pay the BCTFA $3.35 million and to issue it five year warrants for the purchase of 400,000 common shares of the company at a price of $0.56 per common share. This transaction is expected to close on or after April 1, 2004. Currently the Company pays the BCTFA a user fee for each tonne of clean coal produced by the Company. The user fee has a benchmark cost of $2.00 per tonne which varies with the international price of thermal coal. The company is planning to finance this acquisition from working capital and a private debt placement. See note 12(a).

(b) On February 10, 2004, a holder of warrants representing 499,720 common shares of the company exercised its rights to acquire these common shares. The Company received cash proceeds of $179,899 on the exercise of these warrants.

(c) On February 19, 2004, a holder of 2,000,000 warrants out of 4,000,000 warrants exercised its rights to acquire 2,000,000 common shares. The company received cash proceeds of $720,000 on the exercise of these warrants.

(d) In January, 2004, the Company advised the holders of the 682,680 escrowed shares with an ascribed value of $395,954, that the escrow conditions were not met within the time frame stipulated in the agreement to acquire D and R Resources Inc. The Company requested the return of these escrowed shares in accordance with the contract. The former owners of D and R Resources Inc. objected to the return of the shares and filed a claim in the Court of Queen's Bench of Alberta requesting damages of $20.6 million plus certain costs. Over 90% of the stipulated damages related to an undeveloped coal resource which neither Hillsborough nor the plaintiffs currently own or have ever owned or controlled. Management of the Company considers that the claim is totally without merit and intends to vigorously defend it. See Notes 4 and 14 (b).

Corporate Information

DIRECTORS

Michael Fitch, Q.C.(2)(3)

Tom Lindsay(1)(3)

R. Gordon Marantz, Q.C.(4)(3)

Winston D. Stothert, Chairman(1)(2)

George W. Stuart(1)(2)

David J. Slater

(1) Member of the Audit Committee
(2) Member of the Human Resources & Compensation Committee
(3) Member of the Corporate Governance Committee
(4) Member of the Environmental & Safety Committee

OFFICERS

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Vice-President Finance & Corporate Development

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STOCK EXCHANGE LISTING

The Toronto Stock Exchange
TSE stock symbol : HLB